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Intelligence Memorandum

The Bahamas: Economic Currents

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
May 1971

INTELLIGENCE MEMORANDUM

THE BAHAMAS: ECONOMIC CURRENTS

Introduction

1. Following a decade of rapid economic expansion, the Bahamian economy recently has experienced declining investment and falling tourist earnings. These problems reflect rising (though still moderate) economic nationalism, the US economic recession, and the unpleasant experiences some foreign visitors have had. The Pindling government has tried to assuage investors' fears and has mounted a publicity campaign to encourage a more favorable reception for tourists. Its efforts have had little visible effect so far, but it appears that the Bahamas' economic slowdown is only temporary and that prospects for continued rapid development are favorable. Dissidents in Pindling's Progressive Liberal Party nevertheless have been calling for new leaders and policies. This memorandum examines the Bahamas' economic progress and problems and assesses prospects for the next few years.

Discussion

The Islands' Resource Limitations

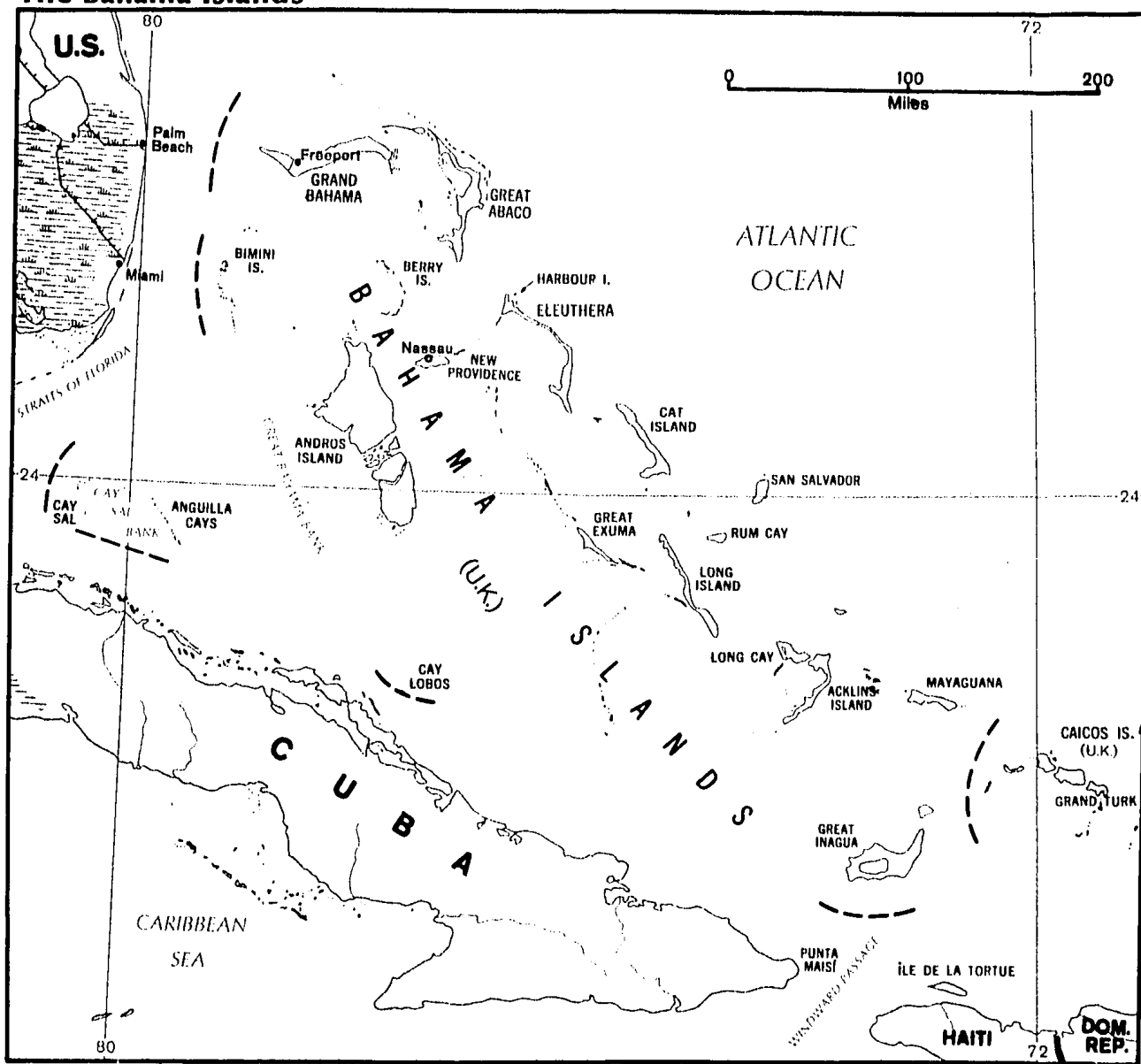
2. The Bahama Islands' resource deficiencies and fractured geography pose special problems of economic development. Fertile land is scarce; only 1% of the islands' 4,400 square miles is cultivated. Mineral deposits are generally lacking. The archipelago stretches nearly 500 miles southeast from the US coast (see the map) and, despite a doubling of population since 1961, currently has only 226,000 people. With few resources and a

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The Bahama Islands



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minuscule internal market, the Bahamas depend heavily on imports for goods of all kinds and have little to export. Still, they are not without economic assets. The salubrious winter climate and plentiful beaches have long attracted tourists. In this and other respects, the Bahamas' nearness to the United States is a distinct advantage. The salt in the surrounding seas supports one of the few industries. Finally, there are some stands of low-quality timber from which pulpwood is obtained.

Developing a Tropical Paradise

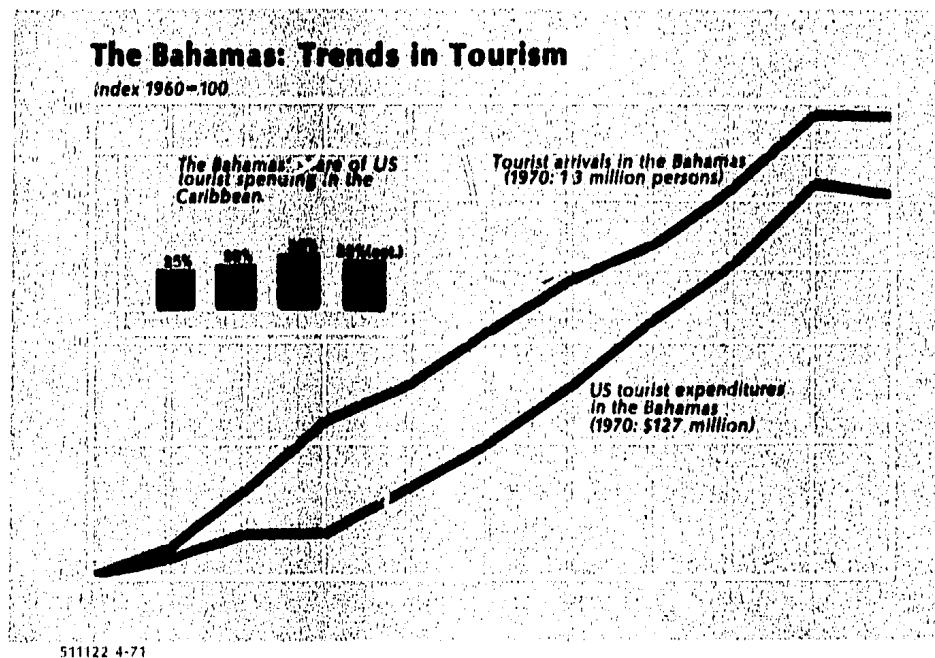
3. During 1961-69, the Bahamian government capitalized effectively on the islands' few economic advantages. Vigorous promotion of business, aided by a history of political stability as a British dependency, produced what must have been the hemisphere's most rapid economic growth – albeit from small beginnings. Although national accounts data are lacking, it appears that per capita output rose appreciably despite population increases averaging 7% annually. The local population is increasing only about 2.5% annually – less than the hemisphere average. Substantial immigration by Europeans and US citizens to take advantage of employment opportunities in construction and management largely accounts for the unusually high rate of population growth.

4. The government took full advantage of growing affluence and interest in travel among US residents. Tourist promotion was further expanded, with special emphasis on off-season activity and resort development in the "out islands" – those other than New Providence Island. Notwithstanding strong competition, total tourist arrivals rose an average of 16% a year during 1961-69 and the Bahamas substantially increased their share of US tourist spending in the Caribbean to 35% in 1969 (see the chart). By 1969 the Bahamas accounted for half of Caribbean tourist arrivals and had gross earnings of \$155 million, or \$775 per capita. ^{1/}

5. In addition, the government attracted considerable foreign investment by offering extraordinary incentives for development of Grand Bahama – a lightly inhabited island only about 60 miles from Florida. The Hawksbill Creek Act of 1955 gave extraterritorial rights to a large part of the island to the Grand Bahama Port Authority, Ltd., a private

1. Available data for Caribbean tourism are not very reliable. The figure given for the Bahamas' earnings should be regarded as a minimum; other estimates range up to \$235 million. In this context, the "Caribbean" excludes Puerto Rico and the US Virgin Islands but includes Bermuda as well as the Bahamas – neither of which, strictly speaking, is part of the area. The data also include tourist expenditures in Central America, which are relatively small.

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corporation founded by Wallace Groves, a US citizen. The Port Authority received a 99-year lease to 234 square miles of land and the power to license businesses and control immigration into the enclave. Freedom from taxes on income, undeveloped land, and capital gains – long enjoyed by all businesses – was guaranteed to investors at Grand Bahama until 1990. Moreover, investors were exempted from levies on developed real estate until 1990 and from excise and customs taxes until 2054.

6. The Port Authority spent large sums building Freeport (now a city of some 20,000 people) and has attracted numerous investors, particularly since 1965. Major investments include an \$80 million oil refinery (designed mainly to supply New York City with desulfurized fuel oil), a \$50 million cement plant, and a number of luxury hotels. The first hotel opened in 1964, and by 1970 Freeport had about 15 establishments, with more than 4,000 rooms and two gambling casinos. Moreover, the Port Authority divided much of its land into smaller plots and sold it for

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apartment and single-family use. By 1969, US direct investment in Freeport (including infrastructure) amounted to an estimated \$800 million. The book value of US investment in the Bahamas now approximates \$1.2 billion, 2/ exceeded in Latin America only by that in Venezuela, Brazil, and Mexico.

7. The Bahamas also developed as a financial center during the 1960s. The tax situation and lax incorporation laws encouraged many banking, trust, insurance, finance, and investment companies to open offices (in some cases, only corporate "shells") for offshore operations. Funds were received not only from the United States but also (since the Bahamas were within the Sterling Area) from the United Kingdom, which was tightly restricting the flow of sterling outside the Area. During the tight money crisis in the United States in the late 1960s, the Bahamas became a major Eurodollar center. By 1970, over 350 banks - including 31 branches of US banks - operated in the Islands, employing some 1,800 Bahamians.

Stirrings of Economic Nationalism

8. Political developments in recent years have brought significant changes in Bahamian economic policy, including attitudes toward foreign investors' privileges. When the Hawksbill Creek Act was signed, the Islands still were a British colony with limited self-government, and the dominant political force was the United Bahamian Party, representing mainly the white, business-oriented community. Charged with corruption and contemptuously labeled the "Bay Street boys" (Bay Street being Nassau's commercial center), the United Bahamian administration was defeated in the 1967 election by the Progressive Liberal Party (PLP), which had the black majority's support. The new black administration, headed by Prime Minister Lynden O. Pindling, called for more local control of the government and the economy and for improved public services. In addition to opening negotiations with the British for full internal self-government, the administration tightened regulations for insurance companies and gambling casinos, obtained passage of legislation aimed at curbing immigration, and began to substantially increase expenditures for education and social services.

9. Although Pindling assured investors that their privileges would be maintained, the government gradually moved to restrict the extraterritorial rights of the Grand Bahama Port Authority. Many public officials complained that foreign-owned businesses hired only foreigners for management positions and that Freeport was a white enclave beyond

2. *Excluding residential real estate, which probably is included (perhaps at inflated estimates of market value) in published figures for US investment ranging as high as \$1.8 billion.*

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government control. In March 1969 the government acquired a 7-1/2% interest in the Port Authority, the remainder being taken over at the same time by Benguet Consolidated, Inc. - a Philippine-based gold mining company with substantial US ownership. Through the purchase agreement, the government gained more control over Freeport, including the right to license new businesses. The government also began enforcing the Immigration Act of 1967 by sharply curtailing work permits for skilled foreigners. Businesses were required to hire qualified Bahamians or train them for available management positions.

10. The government's increasingly nationalistic posture aroused new fears in the business community, which were intensified by Pindling's statement in mid-1969 that "Bahamians are still the victims of an unbending social order which, if it ... refuses to bend, must now be broken." In February 1970 the legislature passed an act giving the government complete control over the immigration at Freeport - in effect, abrogating part of the Hawksbill Creek Act. The investment climate deteriorated further as investors began to wonder if the Act's tax exemption provisions might also be abrogated. Additionally, businessmen feared that the weakening of Britain's restraining influence as the Bahamas moved toward independence would bring more radical action. In May 1969 the Bahamas had obtained full internal self-government and a pledge of eventual independence - now expected in the next few years.

11. Rising economic nationalism also affected the tourist industry.

Moreover, news of "black power" incidents and even of riots on other Caribbean islands was widely circulated in the US press. Concern that such reports were reducing the Bahamas' attractiveness caused the government to institute a "smile" campaign and stress the economic importance of tourism.

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The Economy's Course in 1970

12. Strongly oriented toward the United States, the Bahamian economy suffered a moderate setback in 1970 because of the US recession. Total tourist arrivals (usually 85%-90% American) fell by about 3%, and US tourist expenditures dropped by 4%, compared with annual gains averaging 21% during 1966-69. At the same time, US expenditures elsewhere in the area rose by 6%, reducing the Bahamas' share of the Caribbean total for the first time since 1965. Bahamian hotels experienced a sharp drop in occupancy rates because capacity continued to increase in 1970. New hotels were particularly burdened by low occupancy rates because of their high debt servicing costs. Sluggish tourist business continued into the 1971 winter season. In March 1971 the \$7.5 million International Hotel in Freeport closed after only three months' operation.

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13. Reduced tourist receipts, tight money in the United States, and the uncertain business climate also impeded the Bahamas' economic advance in 1970 by discouraging investment. The value of construction permits fell moderately in Nassau and sharply in Freeport. Economic growth also was hindered by the closing of the Great Abaco Island sugar operation. Bahamas Agricultural Industries, a subsidiary of Owens-Illinois that started raising cane on land that it had exploited for pulpwood, gave up after only two years of production because of high production costs and difficulties in entering restricted markets. Reduced job opportunities in construction, the sugar industry, and tourism raised unemployment to 3%-5% of the labor force by the end of 1970. Government revenues stagnated at the 1969 level, or 12% below budget projections in 1970. Customs receipts, which account for three-fifths of revenues, were 15% lower than planned, and tax receipts from Freeport were about 50% below projections. As a result, expenditures were reduced sharply from budgeted levels, particularly for new programs such as expanding education facilities and teaching staffs.

Economic Aspects of Party Factionalism

14. Pindling's unwillingness to spur economic growth by altering the "Bahamianization" policy caused growing discontent in the PLP ranks during 1970. The Free PLP, a party faction headed by Cecil Wallace Whitfield and supported by many members of the white business community, wanted to improve the investment climate by relaxing immigration restrictions, soft-pedaling government demands for greater control over Freeport, and postponing the quest for full independence. Pindling tried in September 1970 to mollify the opposition by appointing a commission to study the Freeport issue. Businessmen, however, continued to be uneasy - partly because of Pindling's subsequent statement that, although "Grand Bahama has changed ... in some important respects Freeport is not fully subject to the authority of the government" Leaders of the Free PLP attempted to oust Pindling in November 1970, but he survived the vote of confidence by a 19-to-15 margin.

Conclusions

15. Bahamian economic growth during the next several years probably will not match the rapid pace of the 1960s but should improve as the United States recovers from its recession. Despite some difficulties, the Islands remain relatively attractive to tourists and are likely to share in the expanding international travel market.

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16. The outlook for foreign investment still is reasonably favorable, even though the government appears to be moving toward imposition of an income tax on foreign-owned companies. Because income tax payments to the Bahamas can be deducted from tax obligations to the home country under rules designed to prevent double taxation, Bahamian officials see an opportunity to garner needed funds without adding to the firms' overall tax burden. To help maintain a favorable business climate, the government had previously extended most of the special tax benefits allowed enterprises in Freeport to new industrial plants established anywhere in the Islands.

17. There is always the chance, however, that the "black power" movement that has troubled other Caribbean Islands will gain strength in the Bahamas. If this happens, both tourism and investment expenditures are likely to suffer.

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